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IN THE

# Supreme Court of the United States

OCTOBER TERM, 1979

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**No. 79-584**

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RESEARCH EQUITY FUND, INC.,
*Petitioner*

v.

THE INSURANCE COMPANY OF NORTH AMERICA,
*Respondent*

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**On Petition For A Writ Of Certiorari To The United States Court Of Appeals For The Ninth Circuit**

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## PETITIONER'S REPLY MEMORANDUM

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A. RAYMOND RANDOLPH, JR.
SHARP, RANDOLPH & GREEN
Suite 501
1800 Massachusetts Avenue, N.W.
Washington, D.C. 20036
(202) 659-2400

*Attorney for Petitioner*

PRESS OF BYRON S. ADAMS PRINTING, INC., WASHINGTON, D. C.

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1. After the filing of our Petition, this Court decided *Transamerica Mortgage Advisors, Inc.* v. *Lewis,* No. 77-1645 (Nov. 13, 1979). The Court's opinion observes, with respect to a 1976 bill to revise the Investment Advisers Act, that "[t]he Senate Committee reported favorably on the provision as proposed by the Commission, but the bill did not come to a vote in either House."[1]

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[1] *Transamerica Mortgage Advisors, Inc.* v. *Lewis, supra,* 48 U.S. Law Week at 4004 n. 13; *compare* Petition, at p. 20 ("the bill was reported favorably by the Senate Banking Committee, but never reached a floor note in either House").

The court of appeals in this case, however, erroneously referred to the same bill as having been "rejected" by Congress and, what is more, relied on this supposed rejection for its interpretation of Section 17(g) of the Investment Company Act of 1940.[2] Indeed, on the face of its opinion, this mistaken reasoning of the court of appeals constitutes the primary basis for its construction of Section 17(g), as we pointed out in our Petition (Pet., at pp. 20-21).

2. As to the legislative history of Section 17(g) itself, both the court of appeals and now respondent in this Court are silent. Respondent has neither discussed the legislative materials set forth in our Petition (at pp. 16-19), nor offered any reason why Congress would have excluded from bonding coverage portfolio managers like Sanders, who are supplied to mutual funds by investment advisers, when the original draft of Section 17(g) plainly included such persons and no substantial change was intended in the enacted version (see Pet., at pp. 16-18).[3]

[2] The court of appeals said: "In rejecting such legislation, Congress obviously contemplated that the bonding requirement would be applicable only to those persons who are in fact officers or employers of the mutual fund" (Pet. App. 9a).

Our Petition also notes, as did this Court in *Transamerica, supra,* 48 U.S. Law Week at 4004 n. 13, that what Congress did in 1976 regarding another Act can have little or no bearing on what the 1940 Congress intended regarding Section 17(g) (Pet., at p. 20).

[3] In suggesting that the term " 'portfolio manager' has little if no meaning" (Brief in Opp., at p. 10), respondent ignores that Section 17(g) of the original bill used the term "manager" of or for a mutual fund to designate those persons who were subject to bonding coverage and that the bill as enacted, although not using the term, was intended to have the same meaning as the original version (see Pet., at pp. 16 to 18).



While ignoring the history of Section 17(g) of the Investment Company Act, respondent asserts that mutual fund managers like Sanders need not be bonded because there is no bonding requirement for investment advisers[4]—an argument we find difficult to understand in light of respondent's recognition that "Sanders could not be the investment advisor of the fund."[5] But aside from the apparent inconsistency in respondent's position, it is unresponsive to the important issue in this use. What matters is whether a mutual fund's management personnel, supplied by an investment adviser and operating as the functional equivalent of fund employees (Pet. App. 8b), were intended to be treated as fund employees for the purposes of Section 17(g). On that score, the legislative history of Section 17(g) demonstrates beyond doubt that they were.

3. Respondent does not dispute that the issue presented in this case is a highly significant one to the mutual fund industry, to insurers and to investors.

[4] Brief in Opp., at p. 12.

[5] *Id.* at p. 11. Respondent's various references to S.E.C. statements that investment advisers need not be bonded are not only beside the point but also are taken out of context. The Investment Advisers Act, to be sure, contains no bonding requirement. But it is through the Investment Company Act that Congress regulated the relationship between mutual funds and management personnel supplied by their investment advisers. The S.E.C. statements respondent relies upon were not addressed to that situation. As the Commission stated to the court of appeals, it "was referring only to the absence in the Investment Advisers Act of any bonding requirement for advisers generally. The Commission was not suggesting that the Investment Company Act contained no bonding requirement applicable in the case of an adviser to an investment company." (*Memorandum of the Securities and Exchange Commission, Amicus Curial, In Support of Rehearing,* at p. 4 n.5).

The decision below will govern the degree to which investors are protected against dishonesty by mutual fund managers because, as we pointed out in our Petition (at pp. 10-13), the management personnel of most mutual funds are furnished by investment advisers. Review by this Court is thus necessary to avoid subjecting the investing public to substantial risks of loss on the basis of a plain misconstruction of the Investment Company Act, which if left standing can only bring about years of further confusion and litigation.

Respectfully submitted,

A. RAYMOND RANDOLPH, JR.
SHARP, RANDOLPH & GREEN
Suite 501
1800 Massachusetts Avenue, N.W.
Washington, D.C. 20036
(202) 659-2400

*Attorney for Petitioner*

December 1979